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No. 108

In the Supreme Court of the United States

OCTOBER TERM, 1935

JOSEPH E. SWANSON ET AL., TRUSTEES OF THE LAKE VIEW LAND ASSOCIATION, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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v.

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OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 19–30) is unreported. The opinion of the Circuit Court of Appeals (R 44–46) is reported in 76 F. (2d) 651.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 10, 1935. (R. 47.) A petition for a writ of certiorari was filed June 7, 1935, and was granted October 14, 1935. (R. 50.) The

jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the trust involved is an association within the meaning of Section 2 (a) (2) of the Revenue Act of 1926.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> Sec. 2 (a) When used in this Act—
>
> * * * * *
>
> (2) The term "corporation" includes associations, joint-stock companies, and insurance companies. * * *.

Regulations 69:

> Art. 1502. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has

ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 2.

Art. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341–347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

STATEMENT

The facts are not in dispute and, as found by the Board of Tax Appeals, may be summarized as follows:

In 1914, Joseph E. Swanson and Ralph C. Otis acquired a plot of vacant ground in the City of Chicago, which was later designated as No. 3122 Sheridan Road, for the purpose of erecting an apartment house on it. Swanson took title. (R. 26.) Originally 135 feet were purchased for $27,000, but Swanson and Otis sold 50 feet for $17,500 before they started to build on it. (R. 26.)

A three-story apartment building, containing apartments of seven, eight and eleven rooms, was erected on the tract, being completed on May 1, 1914. Swanson and Otis contributed equal amounts to the cost of construction, their total contributions amounting to no more than $30,000 and a mortgage loan of $75,000 was secured to complete the financing. (R. 26.)

At the suggestion of their attorney, on June 1, 1915, they created a trust known as the Lake View Land Association, as a safer way to carry the title. (R. 27.) The trust agreement provided that Swanson, Otis, and Allen G. Mills, all of Illinois, should acquire title to the above-described property and should hold it in trust with power to manage the real estate and improvements, collect the income therefrom and pay the taxes and other expenses. (R. 19–20.)

The trustees were given authority to lease the real estate, or buildings, or any part of them, for any period not to exceed 198 years, to tear down the buildings and erect new ones, to mortgage the property up to 60 percent of its value, to sell the property, or to exchange it for other property and, in general, to do any acts deemed advisable in connection with the trust. (R. 20–21.) Article 4 provided, in substance, that the trustees were not to be prohibited from having transactions with a corporation or trust in which one of them might be an officer or director. (R. 21.) Their compensation for their services was to be fixed as they might determine, provided that it should not exceed 2½% of the gross income of the trust. (R. 21–22.) Neither the trustees nor the beneficiaries were to be personally liable for any obligation of the trust. All persons dealing with the trustees were to look only to trust property for payment. (R. 22.) The trustees were directed to distribute the net income of the trust, semiannually or oftener, in their discretion, according to the respective beneficial interests, and were to render annual statements to any beneficiaries requesting them. (R. 22.)

The interests of the beneficiaries were to be represented by shares or receipts, of a par value of $100 each, aggregating at the beginning $100,000. These shares were stated to be personal property. A register of transfers of interests was to be kept.

(R. 22–23.) Any beneficiary desiring to dispose of his shares was required first to offer them to the other beneficiaries, but if none desired to purchase, he could, after thirty days, dispose of them to outsiders, in which case the assignment was to be given to the trustees and new shares issued. (R. 23–24.) Any vacancy among the trustees was to be filled by the remaining trustees (R. 24–25).

The trust was to terminate at the expiration of twenty years after the death of the last survivor of James Otis, Ralph Chester Otis and Sarane Otis and Florence Otis, children of Ralph C. Otis, and Joseph B. Swanson and Ralph E. Swanson, children of Joseph E. Swanson. However, if the trustees should so decide, they might sell all of the property belonging to the trust and terminate it prior to that time. (R. 25.)

The trust agreement was subject to amendment by an agreement in writing of registered beneficiaries holding three quarters or more in value of the receipts, provided that no third persons should be bound by an amendment until it was recorded in the office of the Recorder of Deeds, Cook County, Illinois. (R. 26.)

Upon the organization of the trust, Otis and Swanson each received 500 shares of beneficial interest. In 1917 and 1920, Otis and Swanson transferred their interests to their wives and they were the only beneficiaries during 1925 and 1926. (R. 27.) About 1926, James Otis, the son of Ralph C. Otis, succeeded his father as trustee. (R. 27.)

Between 1915 and 1932, Swanson was a partner in Willoughby & Company, which was engaged in the business of buying and selling real estate as a broker and also in managing properties, including the Lake View Land Association property. Willoughby & Company negotiated the original leases, which were at first for terms of from three to five years, but later varied. It attended to redecorating, purchasing of coal and all matters pertaining to service and condition of the building. (R. 27.) Swanson and Otis, the latter having an office with Willoughby & Company, though not a member of that firm, directed the management of the property and frequently discussed matters pertaining to the operation of the building. The entire control of the Association was in their hands. (R. 27–28.)

The three trustees as such did not assemble in formal meetings. They never adopted resolutions, kept a minute book, adopted bylaws, or chose officers or a board of directors. The beneficiaries never acted by vote on any matter. (R. 28.)

Several large buildings and apartment houses were constructed near the apartment of the Association. After it was built land in the vicinity increased materially in value, the gross rents of the apartment of the Association increased from $21,000 to $28,000 (in 1926) and operating expenses doubled. (R. 28–29.) The Association had a chance to sell the property for as much as $1,500 a front foot between 1925 and 1929, but did not do so,

as it planned to erect a larger building on the site at some time. The Association never acquired any other real estate. (R. 28, 29.)

The Commissioner held that the Lake View Land Association was taxable as an association and not as a trust and determined deficiencies for 1925 and 1926, based on that and other adjustments not here involved. The Board sustained the action of the Commissioner on the Association issue, and determined deficiencies of $1,535.27 and $1,157.57 for 1925 and 1926, respectively. (R. 30, 31.) The Circuit Court of Appeals sustained the Commissioner's determination.

ARGUMENT

The sole question in this case is whether the trust involved is an association within the meaning of Section 2 (a) (2) of the Revenue Act of 1926.

The same general question is involved in *T. A. Morrissey and James M. O'Brien, Trustees of an express trust, known as the Western Avenue Golf Club* v. *Helvering*, No. 17, October Term, 1935, which has already been argued; in *Helvering* v. *Coleman-Gilbert Associates*, Nos. 78 and 79, October Term, 1935, and in *Helvering* v. *E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2 Express Trust*, No. 238, October Term, 1935. We think that no useful purpose will be served by repeating herein the arguments made in the Government's briefs in the first two of those cases, which we incorporate herein by reference.

Our position is that a trust which is doing business is an association within the meaning of the statute, regardless of whether it employs a seal, by-laws, formal meetings of the trustees analogous to directors' meetings and other devices of a corporation.

The Board made no direct finding that the Lake View Land Association was doing business, but held that it was an association on the authority of the previous decision in *Swanson* v. *Commissioner*, 29 B. T. A. 1123, a similar trust created by Swanson. A reference to that decision removes all doubt that the Board considered that the Lake View Land Association was doing business and that was the view of the court below.

It is clear that the Association was created to operate, for profit, the apartment building, or any other building which might subsequently be erected on the same land. There is no suggestion in the trust agreement that the purpose of the trust was to provide a means of holding the property for a short time until it could be sold, so there is no basis for the argument that the Association was a mere liquidating trust. Such an argument is also refuted by the fact that profitable offers to purchase the property were refused, and that up to 1930 the trustees contemplated the erection of a larger building on the same land.

The Association carried out the purpose for which it was organized; that is, it operated the apartment for profit.

That the management of an apartment house or other rental building for profit constitutes doing business is settled by *Hecht* v. *Malley*, 265 U. S. 144, and *Flint* v. *Stone Tracy Co.*, 220 U. S. 107. See also authorities cited in the brief in the *Coleman-Gilbert Associates* case, *supra*, pp. 10–14. The only distinction between the *Coleman-Gilbert Associates* case and this one, in so far as the doing business test is concerned, is that there the trust was managing several apartment houses, while here it was managing one. We think that the management of one as well as that of many constitutes doing business, when the trust was created for that purpose.

In *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, involving the excise tax imposed on corporations doing business, this Court said (p. 455):

> It was organized for profit and was doing what it principally was organized to do in order to realize profit. The cases must be exceptional, when such activities of such corporations do not amount to doing business in the sense of the statutes. The exemption "*when not engaged in business*" ordinarily would seem pretty nearly equivalent to when not pursuing the ends for which the corporation was organized, in the cases where the end is profit.[1]

For reasons stated in the briefs in the *Morrissey* case and the *Coleman-Gilbert Associates* case, we

[1] We think it unnecessary to discuss at length the suggestion that the fact that Willoughby & Company handled some of the details of the business is important. The business which was transacted was the Association's business and it

believe that the satisfaction of the doing business test should be regarded as conclusive. The petitioners' brief in this case shows how difficult it is to rely upon any other test, for they enumerate a long list of respects in which a trust should resemble a corporation in order to be classified as an association and then confess that some of these are merely negatively essential, others are very or slightly significant, if present but not if absent, and others have no significance. (Br. 22–37.)

The three elements which the petitioners insist upon most strongly, however, are the voluntary nature of the association, at least the minimum of formal organization and business activity. Inasmuch as there is no doubt but that this trust was a voluntary trust, we may dispose of that point without discussing it, although we do not agree that it is essential for the trust to be created by voluntary agreement by the beneficiaries.

We have shown above that there was business activity, so that the only one of three suggested characteristics not disposed of is that of a "minimum of formal organization".

For reasons stated in the *Morrissey* and *Coleman-Gilbert Associates* briefs, we do not think that the presence or absence of formalities, such as trustees meetings, beneficiaries meetings, minutes of meetings, is at all important. Such devices are

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was engaged in business for profit, whether or not the trustees employed an agent. See *Investment Trust of Mutual Investment Co.* v. *Commissioner*, 71 F. (2d) 1009 (C. C. A. 2d), affirming *per curiam* 27 B. T. A. 1322.

often disregarded in close family corporations and are not the attributes which give a corporation in business an advantage over an individual conducting the same business.

The characteristics which do give a corporation an advantage over an individual conducting a similar business are pointed out in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, as follows (p. 162):

> The continuity of the business, without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships.

All of the elements mentioned as characteristic of a corporation are present in this case. We readily concede that they are usually present in most, though not all, trusts. In fact, that is one of the reasons for our position that the doing business test should be the only test required.

But there can be no question that all three elements existed here. There was no individual liability because the trust instrument specifically provided that neither the trustees nor the beneficiaries should be liable and that creditors should look only to the trust funds for payment of trust

obligations.[2] The trust had continuity regardless of the death of a beneficiary, or of changes in the beneficial interests, which were transferable. Its affairs were managed by trustees who could act as effectively for the trust as can a board of directors for a corporation.

We submit, however, that even under the petitioners' theory that a trust should not be held to be an association without a minimum of formal organization, this trust should be classified as an association. The trust had transferable receipts or certificates analogous to shares of stock, of which a register was kept. These certificates had a par value of $100 a share. Clearly, such certificates provide a minimum of corporate form and are more significant than such things as formal meetings of the trustees, or by-laws. See *Tyson* v. *Commissioner,* 68 F. (2d) 584 (C. C. A. 7th), certiorari denied, 292 U. S. 657. It also had a trade name, the Lake View Land Association.

The petitioners also attach some importance to beneficiary control, although in *Hecht* v. *Malley, supra,* it was held that a trust could be an association, regardless of beneficiary control, if it was doing business. For that and other reasons stated in the Government's brief in the *Morrissey* case, *supra,* and the *Coleman-Gilbert Associates* case,

[2] The trust directed the trustees to incorporate a provision to that effect in every contract, so that there could be no question of a limitation of the liability of the trustees under Illinois decisions. *Schumann-Heink* v. *Folsom,* 328 Ill. 321.

supra, we think that the matter of beneficiary control is no longer important. However, we point out that the beneficiaries in this case were not wholly without control, since by a three-fourths vote they could amend the trust instrument.

CONCLUSION

The decision of the court below holding that the trust was an association should be affirmed.

Respectfully submitted.

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